United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

76-7401

United States Court of Appeals

FOR THE SECOND CIRCUIT

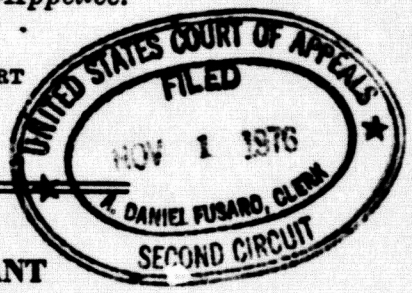
B
P/S

CANADIAN TRANSPORT COMPANY,
a Division of
MACMILLAN BLOEDEL (ALBERNI) LIMITED,
Plaintiff-Appellant,

—against—

IRVING TRUST COMPANY,
Defendant-Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK



REPLY BRIEF ON BEHALF OF PLAINTIFF-APPELLANT CANADIAN TRANSPORT COMPANY

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Reply Brief on Behalf of
Plaintiff-Appellant
Canadian Transport Company

Statement

This brief is submitted on behalf of plaintiff-appellant, Canadian Transport Company ("Canadian") in reply to the Brief of defendant-appellee, Irving Trust Company, ("Irving Trust").

The Misstated "Issue" in Irving Trust's Brief

The issue presented for review, according to Irving Trust, is no issue at all since it mistakenly assumes facts which have not been established and which constitute one of the very reasons for

continuing the preliminary injunction against Irving Trust.

Irving Trust's alleged issue reads as follows:

> "Should defendant-appellee Irving Trust Company be preliminarily enjoined from paying a draft drawn on it under its irrevocable and confirmed letter of credit issued at plaintiff's instance in favor of the beneficiary, Lebanon Steel Mill Company, where the obligation of Irving to pay the draft arose out of plaintiff's instructions, erroneously or carelessly given to Irving not to renew the credit, thus giving rise to the beneficiary's rights to draw?"

This statement of the issue assumes that Irving Trust's Letter of Credit is in fact a confirmed credit. As will be discussed in further detail below, that fact has not been established and important consequences to Canadian's right to enjoin Irving Trust turn on this factual question.

In addition, Irving Trust conveniently assumes the fundamental issue to be decided, which is whether in fact Irving Trust is obligated to pay Arab Bank.

REPLYING TO IRVING TRUST'S POINT I

IRVING TRUST'S ARGUMENTS MERELY CONFIRM THAT CANADIAN HAS RAISED ISSUES GOING TO THE MERITS WHICH ARE A FAIR GROUND FOR LITIGATION

Irving Trust does not contest that the appropriate test for determining Canadian's right to a preliminary injunction is that set out in Sonesta Int'l Hotels Corp. v. Wellington Associates, (Canadian Brief, p. 13). It is therefore important for this Court to note that it is not required to finally determine the legal issues

raised by Canadian in Point II of its brief as grounds supporting its right to a preliminary injunction. Rather the question for this Court is whether, as to such issues, Canadian has made a clear showing of either probable success on the merits or sufficiently serious questions going to the merits to make them a fair ground for litigation.

We submit that Irving Trust's attempted rebuttal of Canadian's arguments clearly demonstrates at a minimum that Canadian has raised "serious questions going to the merits to make them a fair ground for litigation."

Serious Factual Questions to be Resolved

Throughout its Brief, Irving Trust conveniently blurs the distinction between established facts and factual conclusions. At various times Irving Trust asserts categorically that Arab Bank paid Steel Mill on July 28. (Irving Brief, p. 34, 35). Canadian does not concede that "there can be no possible doubt" as to this important issue. Irving Trust's statement represents a factual conclusion on its part which may very well be incorrect. Certainly Canadian's interest in the $225,000.00 proceeds of the Letter of Credit should not rise or fall on the basis of presumed facts for which there is only circumstantial evidence when the appropriate remedy is for the trial court to resolve this issue conclusively.

Similarly, on the important question of whether Arab Bank actually added its confirmation in writing, and if it did, in what precise terms it did so, Irving Trust merely argues that the circumstantial evidence indicates that it must have done so.

That the terms in which a bank adds its confirmation are important can be seen from the Uniform Commercial Code's definition of confirming bank:

> §5 - 103
>
> (1) In this Article unless the context otherwise requires. . .
>
> (f) A "confirming bank" is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank."
> (Emphasis added)

It is therefore entirely possible that Arab Bank merely engaged that the credit would be honored by the issuer, Irving Trust, making Arab Bank itself only secondarily liable under the Letter of Credit in the event of dishonor by Irving Trust. In such case, Arab Bank may well have been waiting until it was advised that Irving Trust had credited its account with $225,000.00 before actually paying Steel Mill; if in fact Arab Bank thereafter paid Steel Mill, as is alleged, such payment may well have been at Steel Mill's instance in order to foreclose reinstatement of the Letter of Credit. The fact that the draft is dated July 28th and that Arab Bank has demanded a credit for "value of 28th" does not necessarily indicate that Arab Bank paid Steel Mill on July 28th, as Irving Trust argues. Rather it could just as easily indicate that Steel Mill presented the draft to Arab Bank on July 28th and that date merely determines the amount in local currency that Steel Mill would be entitled to receive.

Thus, before any determination can be made as to whether Irving Trust should be permanently enjoined from paying Arab Bank, it is necessary for the trial court to resolve the outstanding factual questions as to if and

when the alleged payment to Steel Mill was made and if and in what terms Arab Bank added its alleged confirmation to the Letter of Credit.

Serious Questions Concerning Penalty

Irving Trust misapprehends the thrust of Canadian's argument that, under the circumstances of this case, payment of the draft drawn under the Letter of Credit would constitute enforcement of a penalty. Canadian does not contend that all guaranty letters of credit are necessarily ultra vires for awarding a penalty. The question as to whether a particular sum constitutes a penalty or a valid provision for liquidated damages turns on whether the amount fixed bears a reasonable relation to any probable damage which may follow a breach.

In arguing that payment of the draft here does not constitute a penalty, Irving Trust states

> "The sum of $225,000 which the parties evidently agreed should be the amount of the letter of credit, must represent some concurrence on their part that that sum bore a resaonable relationship to the damages claimed by Lebanon Steel Mill and the amount which might ultimately be payable." (Irving Brief, p. 14).

This argument fails completely to take account of the circumstances under which the Letter of Credit was exacted from the Vessel owner and Canadian in return for release of the Vessel from arrest. Canadian, as charterer of the Vessel, and St. Ioannis Shipping, as owner and account party of Irving Trust's Letter of Credit, were in no position to dispute with Steel Mill whether $225,000 represented a valid measure of its claimed damages, since that necessarily would have resulted in further delay in releasing the Vessel from arrest and further substantial economic loss to both parties. It was therefore

in the interest of Canadian and Owner to obtain the Vessel's release on the best terms possible as soon as possible. Thus at most, the figure of $225,000 merely represents the sum the parties agreed would constitute the amount of the Letter of Credit as the price for the Vessel's release.

The fact that the draft here is presented by Arab Bank rather than Steel Mill does not moot the issue of penalty since it is not established that Arab Bank became a holder in due course by negotiating the draft. Once again it becomes significant to know whether payment was made by Arab Bank with notice of the reinstatement of the credit or with notice of the restraining order against Irving Trust, in which case, payment by Arab Bank would not make it a holder in due course.*

Serious Questions Concerning Non-Conformity of Documents

In Point I, E of its Brief, Irving Trust attempts to minimize the significance of the non-conformities in the documents submitted with Steel Mill's draft and in particular Steel Mill's omission of the word "we" in the statement accompanying the draft which was supposed to read

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* "U.C.C. §3-302 Holder in Due Course

(1) A holder in due course is a holder who takes the instrument (a) for value; and (b) in good faith, and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person."

> "We certify that the settlement of the damages we incurred has not been arrived at and that this liability is still due to us."
>
> (Emphasis added)

Irving Trust argues that there is no doubt that the damages referred to in the statement are damages incurred by the beneficiary and no one else and further characterizes Canadian's argument as based on a "fancied ambiguity". (Irving Brief pp. 25-27). Canadian submits that the ambiguity in the statement required by the Letter of Credit, far from being fanciful, is clear on its face and is further compounded by Steel Mill's omission of the word "we".

In this connection, a recent decision in the Fourth Circuit, Courtaulds North America Inc. v. North Carolina National Bank, 528 F2d 802 (4th Cir. 1975), is significant. The letter of credit there involved was intended to cover a shipment of "100% Acrylic Yarn". The invoice attached to the draft in this case described the goods as "Imported Acrylic Yarn". Payment was refused on the basis of this inconsistency and the District Court upheld the refusal. The Court of Appeals affirmed, stating:

> "Moreover, as the predominant authorities unequivocally declare, the beneficiary must meet the terms of the credit - and precisely - if it is to exact performance of the issuer. Failing such compliance there can be no recovery from the drawee. . .
>
> Free of ineptness in wording, the letter of credit dictated that each invoice express on its face that it covered 100% acrylic yarn. Nothing less is shown to be tolerated in the trade. No substitution and no equivalent through interpretation or logic will serve.

> Harfield, Bank Credits and Acceptances, (5th ed. 1974) at p. 73 commends and quotes aptly from an English case: 'There is no room for documents which are almost the same or which will do just as well.' Equitable Trust Co of N.Y. v. Dawson Partners Ltd., 27 L.L.L.Rep. 49, 52 (1926) Although no pertinent North Carolina decision has been laid before us, in many cases elsewhere, especially in New York, we find the tenet of Harfield to be unshaken."
>
> (528 F2d at 805-808; emphasis added)

We respectfully submit that in the present case, where the Letter of Credit spelled out the precise words of the statement which was to accompany the draft, the omission of the word "we" is fatal and "[n]o substitution and no equivalent, through interpretation or logic will serve."

Serious Questions as to Whether the Letter of Credit is Ultra Vires

In its argument in Point I, C of its Brief, that the Letter of Credit here involved is not ultra vires under New York law, Irving Trust relies on dictum in a footnote in the decision by the District Court of New Jersey in National Surety Corp. v. The Midland Bank & Trust Company, 408 F. Supp. 884 (1976), that drafts drawn under a letter of credit automatically renewable from year to year may nevertheless be enforceable if such drafts were drawn less than a year from the date of issuance of the letter of credit. Whether a New York court would agree with that dictum is, of course, presently unknown since apparently no New York decision has dealt with the issue. However, given the

enormous volume of letter of credit transactions in New York, this issue is clearly a serious one which merits the thorough examination of all relevant legislative history and any other available aids to interpretation of the legislative intent.

The letter from the State of New York Banking Department attached as Annex A to Irving Trust's Brief certainly cannot be deemed conclusive on this question since the assertion there that it has

> "consistently maintained that the legislature intended the one year limitation found in Section 96(2) to apply only to the terms of drafts drawn pursuant to a letter of credit and not to the duration of the letter of credit itself"

is apparently contradicted by the position taken by New York's Superindendent of Banks in the Intra Bank liquidation proceeding in 1966. (See Canadian Brief, p. 25).

The final paragraph of the Banking Department letter is particularly interesting:

> "In passing I would also note that the Banking Department believes as a matter of policy, that the reasonableness of the duration of a letter of credit should be judged by the nature of the underlying transaction secured by the letter of credit. Accordingly, the Department's examiners, as a part of the overall process of bank examination evaluate the reasonableness of the duration of letters of credit on a case by case basis."

Thus we respectfully submit that an issue to be explored by the trial court in this case is whether, in view of the underlying transaction secured by this Letter of Credit, the duration of the Letter of Credit is reasonable as a matter of New York Banking Department policy.

REPLYING TO IRVING TRUST'S POINT II

ARAB BANK AND STEEL MILL ARE NOT INDISPENSABLE PARTIES AND, IN ANY CASE, ARAB BANK CAN BE INTERPLEADED

Irving Trust contends that Arab Bank and Steel Mill are indispensable parties to this action who are not amenable to process and whose joinder would destroy the requisite diversity jurisdiction, all of which it claims requires the dismissal of Canadian's action. However, as will be seen, so drastic a remedy as dismissal is clearly inappropriate here since the major premises of Irving Trust's argument are erroneous on the facts and the law.

First of all, it is essential to distinguish between the interests of Arab Bank and Steel Mill. Since Steel Mill allegedly has been paid the proceeds of the Letter of Credit, it is difficult to understand how it would be prejudiced by an injunction against Irving Trust. Although Irving Trust contends that Arab Bank has claimed an interest in the subject of this action, it does not state that Steel Mill has claimed such an interest. Assuming for the moment that Arab Bank has paid Steel Mill the proceeds of the Letter of Credit, it is obvious that the alleged prejudice to either of them of an injunction against Irving Trust is not the same, and there is no justification for lumping them together. Thus the only real issue is whether Arab Bank is an indispensable party to this action and whether it can be joined.

Dealing with the issue of joinder first, it is well established law that, in a situation such as this in which Irving Trust is faced with conflicting demands as to whether it should pay the

proceeds of the Letter of Credit, the appropriate course for it to take is to counterclaim for interpleader under Rules 13 and 22 of the Federal Rules of Civil Procedure.

Rule 22 interpleader is appropriate here since there is diversity of citizenship between Irving Trust, a New York corporation, as stakeholder, and the claimants, Canadian and Arab Bank, aliens. John Hancock Mutual Life Ins. Co. v. Kraft, 200 F2d 952 (2d Cir. 1953); Republic of China v. American Express Co., 195 F2d 230, 234 (2d Cir. 1952). Further, interpleader of Arab Bank would not destroy the original diversity jurisdiction in this action, since it has been held that such a counterclaim for interpleader would be ancillary to the original action and accordingly would not require an independent basis of federal jurisdiction. Republic of China v. American Express Co., supra; Ciechanowicz v. The Bowery Savings Bank, 19 F.R.D. 367 (SDNY 1956); Marine Midland Trust Co. of New York v. Irving Trust Co., 56 F2d 385, 387 (SDNY 1932).

The facts in Republic of China v. American Express, supra, are analogous to those here involved. There, suit was brought in the United States District Court of the Southern District of New York by the Republic of China (Formosa) against American Express Co., a Connecticut corporation doing business in New York, for recovery of a deposit of $524,990.16. American Express moved for permission to counterclaim for interpleader against the Peoples Republic of China (Peking) which had also claimed title to the money, and the district court granted the motion. On appeal the Republic of China (Formosa) sought reversal of the order allowing interpleader on the ground, among others, that such interpleader would destroy the Court's

diversity jurisdiction by leaving only aliens as parties to the suit. This Court declined to do so, stating that the litigation of the interpleader action would be ancillary to the original suit and the initial jurisdiction of that was sufficient. 195 F2d at 234.

Irving Trust's contention that Arab Bank is not amenable to process is also without merit. It is Irving Trust's view that the draft and accompanying statement received from Arab Bank constitute a matured obligation to pay Arab Bank $225,000. The draft is a negotiable instrument and as such constitutes a res sufficient to render Arab Bank amenable to process under 28 U.S.C. §1655.*

On the remand of Republic of China v. American Express, 108 F. Supp. 169, 170 (SDNY, 1952), the district court ruled that Republic of China must establish jurisdiction in the court by proper service upon the possible adverse claimants, stating:

> "Such jurisdiction is established by one of three methods, either (a) voluntary appearances by the interpleaded defendants, (b) personal service upon them within the territorial jurisdiction of the court in interpleader or, (c) constructive service by compliance with §1655 of Title 28 U.S.C.A." (Emphasis added)

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* §1655 Lien enforcement; absent defendants

In an action in a district court to enforce any lien upon or claim to, or to remove any incumbrance or lien or cloud upon the title to, real or personal property within the district, where any defendant cannot be served within the State, or does not voluntarily appear, the court may order the absent defendant to appear or plead by a day certain.

Such order shall be served on the absent defendant personally if practicable, wherever found, and also upon the person or persons in possession or charge of such property, if any. Where personal service is not practicable, the order shall be published as the court may direct, not less than once a week for six consecutive weeks. . . ."

This procedure for service of process under 28 U.S.C. §1655 was specifically followed in A/S Kredit Pank v. Chase Manhattan Bank, 155 F. Supp. 30 (SDNY 1957), a case involving interpleader under Rule 22(1) of an Estonian bank and a Soviet bank as adverse claimants to certain securities and a credit balance in a Chase Manhattan Bank account. The court stated that

> "the securities now held by Chase for this account plainly constitute personal property within the district to which a claim has been asserted. None of the interpleaded defendants are within the State of New York. Chase appears to be entitled to an order directing the absent defendants to appear and plead under Section 1655." 155 F. Supp. at 36.

Recently the Fifth Circuit has approved this procedure in a statutory interpleader action involving undistributed assets of a decedent's estate, United States v. Swan, 441 F2d 1082, 1085-1086 (5th Cir. 1971). There the Court discussed the issue in the following terms:

> "Where, as here, the property is located within the district in which the District Court sits, the action may also fall within that class of actions defined by Section 1655. We believe that Congress did not intend to exclude from coverage under Section 1655 actions such as this one, in which the stake consists of the assets of an estate on deposit in a bank pursuant to court order, the claims are numerous and service by publication constitutes a reasonable mode of conveying notice to an absent party."

See also Georgia Savings Bank & Trust Company v. Sims, 321 F. Supp. 307 (N.D. Ga. 1971) in which the court upheld jurisdiction in rem as to a bank account in an interpleader action brought under Rule 22 of the Federal Rules of Civil Procedure.

Thus it is clear that by counterclaiming for interpleader against Arab Bank, service of process could be effected as provided in 28 U.S.C. §1655 or alternatively under Rule 4(i)(1) of the Federal Rules of Civil Procedure which provides,

> (i) "Alternative provisions for Service in a Foreign Country"
>
> (1) Manner. When the federal or state law referred to in subdivision (e) of this rule authorizes service upon a party not an inhabitant of or found within the state in which the district court is held, and service is to be effected upon the party in a foreign country, it is also sufficient if service of the summons and complaint is made. . .
>
> (D) by any form of mail, requiring a signed receipt, to be addressed and dispatched by the clerk of the court to the party to be served. . . .

Irving Trust's contention that Arab Bank is an indispensable party is also without merit. The basic issue of this action is whether Irving Trust should pay out the proceeds to Arab Bank of its Letter of Credit. As we have noted in our main Brief, there are significant facts which remain to be established which are material to the determination of that issue. Those facts, however, can be adduced in the subsequent trial of this action without making Arab Bank a party. Thus, under the test of Rule 19(a)(1) complete relief can be accorded the present parties in the absence of Arab Bank.Although Irving Trust asserts that Arab Bank claims an interest in this action, (Irving Brief p. 31), it is apparent that, despite its having notice of these proceedings, (Add. 17-18) Arab Bank has not bothered to appear. It is not for this Court to decide for Arab Bank whether it has a sufficient interest in this proceeding to

warrant retention of local counsel to appear on its behalf. Finally, the risk that Irving Trust faces of the possibility of a suit against it by Arab Bank is a risk for which there is a tailored remedy, namely interpleader.

Certainly it ill behooves Irving Trust to urge the absence of Arab Bank as a ground for dismissal of Canadian's action when Canadian is unable to rectify that absence, and Irving Trust, the party with the main interest in joining Arab Bank, has failed to utilize the obvious remedy.

REPLYING TO IRVING TRUST'S POINT III

THE FACTS CONCERNING PAYMENT BY ARAB BANK TO STEEL MILL ARE IN DOUBT AND, IN ANY EVENT, PAYMENT ON JULY 28th WOULD NOT BE DISPOSITIVE OF OTHER QUESTIONS IN THIS CASE

Irving Trust argues from the available information that Arab Bank paid Steel Mill on July 28, 1976 and that this "fact", in itself, warrants denial of Canadian's motion for a preliminary injunction. As indicated previously, this argument is based upon deductions made from circumstantial evidence. Canadian does not concede that payment was made on July 28 and submits that the issue of when the alleged payment was made should be determined by the trial court.

Further Irving Trust's argument ignores the other serious questions raised by Canadian concerning the non-conformity of Steel Mill's documents, Arab Bank's status as a confirming bank and the enforceability of the Letter of Credit under New York Banking Law and general contract principles. Canadian submits that these also should be resolved at trial.

REPLYING TO IRVING TRUST'S POINT IV

CANADIAN IS ENTITLED TO AN INJUNCTION IN VIEW OF THE SERIOUS QUESTIONS IT HAS RAISED CONCERNING POSSIBLE VIOLATION OF NEW YORK PUBLIC POLICY

Irving Trust contends that Canadian is not entitled to an injunction on the ground that Canadian has an adequate remedy at law against Irving Trust for damages if Irving Trust pays Arab Bank and such payment is later held to have been wrongful. This contention is dealt with at pages 33-35 of Canadian's main Brief.

However, quite apart from the issue of adequate remedy at law, Canadian has raised two issues which involve possible violation of New York public policy regarding penalties and the permissible duration of letters of credit. Given the strong public policy against the enforcement of penalties and the serious issue as to whether this Letter of Credit is ultra vires under New York Banking Law, the issuance of a preliminary injunction in the present case is particularly appropriate pending the trial of these issues.

FINAL POINT

For all of the reasons discussed above, we respectfully submit that this Court should grant a preliminary injunction against Irving Trust restraining it from honoring the draft presented by Arab Bank under the Letter of Credit pending the trial of this action.

Dated: New York, New York
October 29, 1976

Respectfully submitted,

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Jacques L. Jones
Of Counsel

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- x

CANADIAN TRANSPORT COMPANY, a Division of MacMILLAN BLOEDEL (ALBERNI) LIMITED,

Plaintiff-Appellant,

-against-

IRVING TRUST COMPANY,

Defendant-Appellee.

- x

CERTIFICATE OF SERVICE

OF BRIEF

WE HEREBY CERTIFY that two copies of the attached reply brief were this date served on the following:

WINTHROP, STIMSON, PUTNAM & ROBERTS
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Dated: New York, New York

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